How Will Crescent Point Energy Corp. Fund its 7.5% Dividend?

Description

Crescent Point Energy Corp. (TSX:CPG)(NYSE:CPG) slashed its monthly payout by over 50% last month, but even paying its reduced dividend is going to be challenging.

To understand why, you just need to look at its second-quarter numbers. Free cash flow came in at roughly $150 million, which would be enough to cover the current dividend, but that was with oil trading at close to US$60 per barrel. Now with oil in the mid-40s, cash flow is going to take a hit. Crescent Point will also come under pressure as its hedging program loses its effectiveness.

So, that brings up an obvious question: how will Crescent Point fund its dividend? Below we take a look at three possibilities.

1. Increases in cash flow

In an ideal scenario, Crescent Point's cash flow will grow to the point where it can fund the dividend. There are three ways the company could achieve this: an oil price rebound, further cost cuts, or an increase in production. Unfortunately for Crescent Point shareholders, they can't truly count on any of these three outcomes.

To start, oil prices will remain under pressure for quite some time, especially as Iran ramps up its exports. Meanwhile, the Chinese economy continues to struggle, putting a big question mark on the demand picture.

Cost cuts are certainly a better bet. Crescent Point has already reduced per-barrel operating expenses by 7% in just the last 12 months, aided in part by lower drilling rates. But here's the problem: other companies have been doing the exact same thing, which has held oil prices down. So, in order for Crescent Point to get a real boost from cost cuts, it must outcut its competitors. We've yet to see evidence this will happen.

Increases in production are also possible, but the only way to achieve significant growth is by spending big money up front. Doing so would make the dividend harder to pay in the short term.

2. More capital

This is how Crescent Point funded its dividend through the first six months of this year. In the first quarter, it was debt. Then in the second quarter, the company issued equity. To be fair, this wasn't entirely used to fund the dividend. Crescent Point also made a big acquisition in the second quarter.

Looking ahead, the company may raise even more capital. It has even filed a short form prospectus, which would make capital raising easier down the road.

But this would be a bad way to fund the dividend. Crescent Point's net debt has already increased to $4 billion, an increase of 25% in just six months, right as its cash flow has plummeted. Meanwhile, raising equity would also increase the dividend burden down the road, since dividends would have to be paid on a greater number of shares. It would also be very expensive, given how far the company's stock price has fallen.

3. Asset sales

Many companies have kept themselves afloat by selling off assets. But this is exactly the problem—because there are so many sellers, it's hard to get a decent price using this strategy. In any case, Crescent Point has shown little inclination to dispose of assets.

At this point, Crescent Point has few options for funding its dividend long term. If you're looking for a safe payout, you're better off with one of the stocks revealed below.

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